Legislative Alert

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Looking Ahead: Tax Reform in the 113th Congress

As we approach the election next month and the subsequent lame duck session of Congress, many are already looking ahead to next year and the new 113th Congress and second Obama Administration or first Romney Administration and what looks to be shaping up as a defining issue – tax reform.

Recent comments by House Speaker Boehner that the lame duck is not likely to enact a sweeping budget deal to address the “fiscal cliff” – of which comprehensive tax reform would be a part – supports the view that this is an issue that will wait until 2013.

In broad terms, the debate over tax reform, both corporate and personal, will be dictated by two competing views – the Democratic desire to create new revenue and the Republican goal of keeping tax reform revenue neutral.

Given the complexity of tax reform, the groundwork is already being laid for a rigorous debate next year and all indications are that both parties in Congress are serious about taking it on.

Already, the Senate Finance Committee, over the past year, has held hearings on tax reform focusing on the implications for business entities, capital investment and manufacturing, capital gains, education, energy policy, tribes and territories, and state and local tax and fiscal policy.

The House Ways and Means Committee, likewise, has held hearings over the past year to discuss tax reform and the manufacturing sector, retirement accounts, closely-held businesses, financial products, and the interaction of tax and financial accounting on tax reform.

Most telling of the seriousness of the congressional will to tackle tax reform is that the Democratic Chairman of the Senate Finance Committee Max Baucus (D-MT) and the Republican Chairman of the House Ways & Means Committee Dave Camp (R-MI) convened a joint hearing on “Tax Reform and the Tax Treatment of Capital Gains” in September just before congress recessed for the elections.

Big ticket items that are sure to be addressed in the debate over tax reform are the corporate tax rate, territorial tax, special deductions (like the mortgage deduction), the R&D tax credit, bonus depreciation, LIFO (last-in, first-out accounting), the estate tax, capital gains, private equity, and the so-called “Bush tax cuts” and whether they are extended for everyone or just the middle class.

Between 2011 and 2022 there are more than 120 federal tax provisions expiring, or expired, on a statutorily specified date. Included in those numbers are provisions affecting virtually all sectors of the economy, including transportation, education, housing, energy, environment, charitable deductions, pensions, real estate, health insurance, and housing. In the 2011-2013 period there are 9 expiring, or expired, temporary disaster relief federal tax provisions, related to the New York Liberty Zone, Gulf of Mexico hurricane relief, and relief for the 2008 Midwestern tornados and flooding.

Among the expired or expiring provisions are the student loan interest deduction, the credit for health insurance costs, the automatic amortization extension and funding rules for multiemployer defined benefit pension plans, the credit for maintenance of railroad tracks, and even a deduction for race horses two years old or younger. Also on the table will be discussions about the treatment of tax free municipal bonds, and the treatment of carried interest.

In the energy sector alone, the covered provisions included credits for energy efficient appliances and construction of new energy efficient homes, incentives for alternative fuel and alternative fuel mixtures, the cellulosic biofuels producer credit, the wind production tax credit, the energy efficient commercial buildings deduction, qualified green buildings and sustainable design project bonds, the credit for hybrid solar lighting systems and the increased credit for business solar energy property, the energy credit for geothermal heat pump, small wind, and combined heat and power property, the credit for fuel cells and microturbines, the credit for residential energy property, and the credit for production from certified advanced nuclear power facilities.

In addition to the debate over extending existing energy-related tax provisions, we expect a discussion of new tax incentives for renewable energy and energy efficiency, and we will likely see the reintroduction of legislation to expand master limited partnerships (MLPs) to include renewables, as well as legislation to apply real estate investment trusts (REITs) to renewables.

In August the Senate Finance Committee approved the *Family and Business Tax Cut Certainty Act of 2012* – generally termed the “tax extenders” package. Although the House Ways and Means Committee has not approved a similar bill, it is widely expected that the upcoming lame duck session of Congress will see action on a tax extenders package. However, any extensions are likely to be limited and subject to further review in next year's comprehensive tax reform effort.

As always, political concerns play a role in the timing and prospects tax reform. Senate Finance Chairman Baucus is up for reelection in 2014, as are committee members John Cornyn (R-TX), Pat Roberts (R-KS), Mike Enzi (R-WY), John Kerry (D-MA), and Jay Rockefeller (D-WV). All members of the House of Representatives, of course, are up for reelection in 2014. There will be a push to move early on this issue, before the 2014 election season further complicates what is already a challenging task.

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